

STATE OF MONTANA COMPLIANCE SUPPLEMENT FOR AUDITS OF LOCAL GOVERNMENT ENTITIES	REF: C/T-7
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PROGRAM/SUBJECT: Cities and Towns - Payroll and Employee Benefits	

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

HOLIDAY BENEFITS:

1. Compliance Requirements:

- The paid holidays must be restricted to the following: New Years Day, January 1; Martin Luther King Day, the third Monday in January; Lincoln's and Washington's Birthday (President's Day), the third Monday in February; Memorial Day, the last Monday in May; Independence Day, July 4; Labor Day, the first Monday in September; Columbus Day, the second Monday in October; Veteran's Day, November 11; Thanksgiving, the fourth Thursday in November; Christmas, December 25; and State general election day. (MCA 1-1-216)
- AGO #116, Vol. 38, held that the county commissioners may enter into a collective bargaining agreement with county employees which grants a day of paid leave in addition to those legal holidays set forth above. These days may not accumulate as vacation days. This opinion would also appear to apply to city and town employees.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

HOLIDAY BENEFITS - continued:

1. Compliance Requirements - continued:

- If the holiday falls on an employee's day off, the employee is entitled to receive a day off with pay either on the day preceding the holiday or on another day following the holiday. Part-time employees receive pay for the holiday on a prorated basis. A short-term worker, as defined by MCA 2-18-101, may not receive holiday pay. (MCA 2-18-603)
- If a holiday falls during an employee's annual vacation, that day should not be counted against leave time. If counted against leave time, the employee must be given a paid day off at a later time to make up for the lost holiday. (AGO #16, Vol. 38)
- County road and bridge department employees regularly working four 10-hour days per week are entitled to eight hours' pay for all nonworked holidays. (AGO # 14, Vol. 43) Although this opinion refers to a county road and bridge employee, it appears that the intent of the opinion would also apply to any city or town employee regularly working four 10-hour days per week.

Suggested Audit Procedures:

- Determine, by reviewing selected payroll records, the minutes of the governing body, and other available documentation, that paid holidays were restricted to those named above.
- Test payroll records for selected part-time employees to determine if they receive pay for paid holidays on a prorated basis.
- Test payroll records for selected temporary and seasonal employees to determine that they did not receive any holiday pay. If the city or town employs any short-term workers, as defined by MCA 2-18-101, determine that they also did not receive holiday pay.
- Test payroll records to ensure that employees regularly working four 10-hour days receive only 8 hours' pay for a nonworked holiday.

RETIREMENT SYSTEMS:

2. Compliance Requirements:

- Except as otherwise provided in MCA 19-3-403, all employees of a local government participating in the Public Employees Retirement System (PERS) (i.e., contracting

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

2. Compliance Requirements - continued:

- employer) shall become members of the PERS on the first day of service. (MCA 19-3-401)
- The following city or town employees may also become members of the PERS at their option: (MCA 19-3-412)
 1. elected officials of the city or town who are paid on a salary or wage basis rather than on a per diem or other reimbursement basis;
 2. part-time employees whose employment does not exceed a total of 960 hours of employment covered by Title 19, Chapter 3, MCA, in any fiscal year; and
 3. the chief administrative officer of any city or town.
- (Note:** If an employee declines *optional* membership, the employee shall sign a statement waiving membership and file it with the employer, who shall then file the statement with the Public Employees' Retirement Board and retain a copy of the statement. (MCA 19-3-412))
- Local governments may make the decision to join and/or terminate participation in PERS based on employee votes, as noted below:
 1. Any employee who has continuously been, for a period of at least 2 years, an employee of a municipal corporation, county, or other public agency of this state which is not a contracting employer may advise the legislative body of his employer, in writing, that he wishes to participate in the retirement system. Within 30 days after receipt of such written request, the legislative body shall thereupon adopt the resolution of intention and take such action as provided for in 19-3-201. (MCA 19-3-202)
 2. Any municipal corporation, county, or public agency in the state may become a contracting employer and make all or specified groups of its employees members of the retirement system by a contract. The governing body must adopt a resolution of intention to approve the contract and the contract may not be approved unless the employees proposed to be included in the retirement system adopt the proposal by a majority affirmative vote in a secret ballot. Approval of the contract must be made within 40 days after the adoption of the resolution. The contract must specify that the provisions of the retirement system apply to all employees on the effective date of the contract and to all employees hired after the effective date of the contract. An employee's membership in either the defined benefit plan or the defined contribution plan is determined on an individual basis. (MCA 19-3-201) This Section also provides information related to terminating coverage.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

2. Compliance Requirements - continued:

(**Note:** To obtain a listing of cities and towns that are participating members of PERS, go to <http://mpera.mt.gov/> . Click on the “Publications” tab, then “Annual Reports” and then “Statistical Section”. The “Schedule of Participating Employers” is near the end of the Statistical Section.)

Suggested Audit Procedures:

- Test employee payroll records and determine that there have been PERS contributions made by the city or town and the employee for all employees that are required to belong to PERS or who are eligible and have elected to join PERS.
- Determine if any employees have declined optional membership. If so, review the employer’s files for a statement documenting that the employee waived membership.

3. Compliance Requirements:

- The following are the required contributions to retirement systems expressed as a percentage of the employee’s gross pay:

1. Public Employees Retirement System (PERS)

- a. Employer Contribution – MCA 19-3-316
 - 6.8% – (6.9% less State contribution of 0.1%)
 - 6.935% – **Effective 7/1/2007** (7.035% less State contribution of 0.1%)
 - 7.07% – **Effective 7/1/2009** (7.17% less State contribution of 0.1%)
- b. Employee Contribution (withholding) – MCA 19-3-315
 - 6.9%
- c. State’s share– MCA 19-3-319
 - 0.1%

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

3. Compliance Requirements - continued:

2. Municipal Police Officers' Retirement System (MPORS)(Police Retirement - Statewide Plan)
 - a. Employer Contribution – MCA 19-9-703
 - 14.41% –
 - b. Employee Contribution (withholding) – MCA 19-9-710
 - 5.8% - if first employed on or before June 30, 1975
 - 7% if first employed after June 30, 1975
 - 8.5% if first employed after June 30, 1979 but before July 1, 1997
 - 9% if first employed on and after July 1, 1997

(Note: An employee who elects to be covered by the guaranteed annual benefit adjustment (GABA) (19-9-1009 or 19-9-1010) shall contribute 9%)
 - c. State's Contribution– MCA 19-9-702
 - 29.37%
3. Firefighters' Unified Retirement System (FURS)
 - a. Employer Contribution – MCA 19-13-605
 - 14.36% –
 - b. Employee Contribution (withholding) – MCA 19-13-601(2)
 - 9.5% if the employee has **not elected** to be covered under the guaranteed annual benefit adjustment (GABA) MCA 19-13-1010, OR
 - 10.7% if the employee has **elected** to be covered under GABA
 - **AND**, 1% - to pay the premium for group life and accidental death and dismemberment insurance. (MCA 19-13-601(1)).
 - c. State's Contribution – MCA 19-13-601
 - 32.61%
4. Sheriffs' Retirement System (SRS)
 - a. Employer Contribution – MCA 19-7-404
 - 9.535% –
 - 9.825% – **Effective 7/1/2007** (9.535% plus additional contributions of 0.29% for the system's unfunded liability.)
 - 10.115% – **Effective 7/1/2009** (9.535% plus additional contributions of 0.58% for the system's unfunded liability.)
 - b. Employee Contribution (withholding) – MCA 19-7-403
 - 9.245%

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

3. Compliance Requirements - continued:

5. Teachers Retirement System (TRS)

- a. Employer Contribution – MCA 19-20-605
 - 7.47% –
 - 9.47% – **Effective 7/1/2007**
 - 9.85% – **Effective 7/1/2009**
- b. Employee Contribution (withholding) – MCA 19-20-602
 - 7.15%
- c. State's share – MCA 19-20-604
 - 0.11%

6. Police Retirement – Local Funds (For cities with police departments not required to or not electing to participate in the Statewide Municipal Police Officers' Retirement System (MPORS)) –

- a. Employer Contribution – MCA 19-19-301
 - 11% –
- b. Employee Contribution (withholding) – MCA 19-19-302
 - 6%

(Note: The City Treasurer may not withhold contributions for the retirement fund from a temporary officer's compensation, as the purpose of the retirement fund is to benefit active officers who have completed 20 years or more of service. (AGO #29, Vol. 41))

(Note: The Sheriff's Retirement System and the Teacher's Retirement System (usually only for the County Superintendent) will not normally apply to city and town governments. A possible exception may be certain consolidated city/county governments.)

Suggested Audit Procedure:

- Test selected payroll reports and records to determine if the required amounts are withheld from the employees' salaries and/or paid by the employer for the purposes listed above.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

4. Compliance Requirements: (Applicable to PERS, SRS, MPORS, and FURS)

- For purposes of retirement systems, "compensation" means remuneration paid ... before any pretax deductions allowed by state or federal law are made. (MCA 19-3-108(1) (PERS); 19-7-101(1)(SRS); 19-9-104(1)(MPORS) and 19-13-104(2)(FURS))
(**Note:** In addition, MCA 19-3-108(1), pertaining to PERS, specifically states that compensation does not include contributions to group insurance, such as that provided under 2-18-701 through 2-18-704.)
- Pre-tax deductions, including elective contributions under an IRC section 125 (Section 125) cafeteria plan, may be considered compensation for purposes of these retirement systems, but only if the following conditions are met:
 - If an employer increases a member's compensation to account for health, dental, vision, life or disability costs, the amount of the increase can be included in compensation for retirement system purposes only if the employer includes that amount, to the extent required by applicable federal and state law, in its calculation of the member's compensation for all purposes, including but not limited to federal and state income taxes, FICA, unemployment insurance, overtime, shift differentials, workers' compensation, and benefits based on compensation, such as life or disability benefits based on a multiple or percentage of annual pay.
 - The cafeteria plan must be a bona fide cafeteria plan that is operated in compliance with the following requirements of Section 125 (See details at MPERA policy website, below):
 1. The written plan document must incorporate all Section 125 operating rules and regulations and must be formally adopted before the first day of the first plan year.
 2. All participants in the plan must be employees – self-employed individuals and independent contractors cannot participate.
 3. The plan must allow participants to choose among 2 or more benefits consisting of cash and qualified benefits. A plan that does not include the option of receiving cash instead of a qualified benefit is not eligible.
 4. Employees must be allowed to choose between the qualified benefit and cash either through an affirmative election, a mandatory election, or a waiver of participation.
 5. The cafeteria plan may offer only qualified benefits as defined under Section 125(f).
 6. Elections made under the cafeteria plan must be irrevocable for an entire plan year, except to the extent mid-year election changes are permitted under Section 125.
 7. The cafeteria plan must satisfy the nondiscrimination requirements of Section 125.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

4. Compliance Requirements - continued:

(Montana Public Employees' Retirement Board – Policy No. BOARD Admin 05, effective date of 12/9/2005 – see <http://mpera.mt.gov/Policies.asp>) (**Note:** This policy, clarifying the definition of compensation for retirement system purposes, was approved by the Board on 12/9/2005. A participating employer must demonstrate compliance with this policy effective with the next “125 plan” year that follows 8/25/05.)

Suggested Audit Procedures:

- Review the employer's Section 125 cafeteria plan, including the elective deferrals that are offered, and ensure that it meets the above requirements.
- For selected individuals that are members of the above retirement systems, including one or two individuals with management positions, determine the compensation (total wages) reported to the applicable retirement system. (**Note:** Monthly reports to the retirement systems include a listing of individuals, along with reported compensation and contributions made.) Compare this compensation to the total wages, salaries, etc. reported for worker's compensation or state unemployment purposes. If differences exist, perform appropriate follow-up procedures to determine the cause of the differences. (**Note:** Differing due dates for worker's compensation and state unemployment reports may result in differences that will need to be reconciled.)

ANNUAL VACATION LEAVE:

5. Compliance Requirements:

- Permanent full-time employees earn annual vacation leave credits based on total years of employment, as follows: (MCA 2-18-612)
 - a. less than 10 years service - 15 working days per year
 - b. 10 through 15 years service - 18 working days per year
 - c. 15 through 20 years service - 21 working days per year
 - d. Over 20 years service - 24 working days per year
- Employees earn vacation leave from the first day of employment, but must be continuously employed for six calendar months before they are eligible to take any vacation leave. (MCA 2-18-611(1))
- No vacation leave shall accrue while an employee is in a leave-without-pay status. (MCA 2-18-611(4))

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ANNUAL VACATION LEAVE - continued:

5. Compliance Requirements - continued:

- Permanent part-time employees receive prorated annual vacation leave credits if they have worked for the qualifying period. (MCA 2-18-611(3))
- Seasonal employees earn vacation credits. However, seasonal employees must be employed for 6 qualifying months before they may use the vacation credits. In order to qualify, seasonal employees shall immediately report back for work when operations resume in order to avoid a break in service. (MCA 2-18-611(2))
- Temporary employees earn vacation leave credits but may not use the credits until after working for 6 qualifying months. (MCA 2-18-611(5))
- Short-term workers, as defined in 2-18-601, may not earn vacation leave credits, and time worked as a short-term worker does not apply toward the person's rate of earning vacation leave credits. (MCA 2-18-611(6))

(Note: An elected official is not considered an “employee” for the purposes of Title 2, Chapter 18, Part 6, MCA which deals with leave time. (MCA 2-18-601(4) and AGO # 4, Vol. 37)

Suggested Audit Procedure:

- Test the vacation leave records for selected employees to determine if the employees are earning the appropriate number of vacation days, in accordance with the above requirements.

6. Compliance Requirements:

- Annual vacation leave may be accumulated to an amount not to exceed two times the maximum number of days earned annually as of the end of the first pay period of the next calendar year. Excess vacation time is not forfeited if taken within 90 calendar days from the last day of the calendar year in which the excess was accrued. (MCA 2-18-617)

(Note: See Compliance Requirement No. 5 above for the maximum annual vacation leave credits that can be earned.)

- If an employee makes a reasonable written request to use excess vacation leave before the excess vacation leave must be forfeited and the city or town denies the request, the excess vacation leave is not forfeited and the city or town shall ensure that the employee may use the excess vacation leave before the end of the calendar year in which the leave would have been forfeited. (MCA 2-18-617)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ANNUAL VACATION LEAVE - continued:

6. Compliance Requirements - continued:

(**Note:** See Compliance Requirement No. 10 – **Effective July 1, 2007**, an employee may contribute accumulated vacation leave to a nonrefundable sick leave fund provided for in MCA 2-18-618.)

Suggested Audit Procedures:

- Test the vacation leave records for selected employees to determine that vacation leave balances of employees did not exceed the maximum allowed by statute as of the end of the first pay period of the next calendar year.
- If the vacation leave balance was in excess of the maximum allowed, determine that the excess was either used within 90 days from the last day of the calendar year in which the excess was accrued, or forfeited unless the employee made a reasonable request to use the leave and the request was denied.

7. Compliance Requirements:

- Employees will receive pay for vacation leave not used if the employee terminates employment, has worked for the 6 month qualifying period, and has not terminated employment for a reason reflecting discredit on the employee. (MCA 2-18-617(2))
- Employees are not allowed to receive pay in lieu of vacation days not used, except upon termination. (MCA 2-18-617(2); AGO #33, Vol. 25; AGO #25, Vol. 46)

Suggested Audit Procedure:

- As part of expenditure testing for personal services, determine that any payments for unused vacation leave were only made if the employee terminated employment with the city or town.

SICK LEAVE:

8. Compliance Requirements:

- Permanent full-time employees earn 12 days of sick leave per year and there is no restriction on the number of hours that may be accumulated. (MCA 2-18-618(1))
- Employees earn sick leave from the first day of employment, but must be continuously employed for 90 days before they are eligible to use any sick leave. (MCA 2-18-618(1))

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

SICK LEAVE - continued:

8. Compliance Requirements - continued:

- An employee may not earn sick leave while in a leave-without-pay status. (MCA 2-18-618(2))
- Permanent part-time employees receive prorated sick leave credits if they have worked for the qualifying period of 90 days. (MCA 2-18-618(3))
- Full-time temporary and seasonal employees are entitled to sick leave benefits if they have worked the qualifying period of 90 days. (MCA 2-18-618(4))
- A short-term worker may not earn sick leave credits. A short-term worker is a person who is hired by a city or town for an hourly wage; may not work for the city or town for more than 90 days in a continuous 12-month period; is not eligible for permanent status; and may not be hired into another position by the agency without a competitive selection process. (MCA 2-18-101 and 2-18-618(5))

Suggested Audit Procedure:

- Test the sick leave records for selected employees to determine that the employees are earning the appropriate number of sick leave credits based on their employment status and length of employment.

9. Compliance Requirements:

- Except as discussed in Compliance Requirement No. 18 (VEBA), below, upon termination of employment, an employee is entitled to a lump-sum payment equal to $\frac{1}{4}$ of the pay attributed to the accumulated sick leave. The pay must be computed on the basis of the employee's salary or wage at the time of termination. (MCA 2-18-618(6))
- An employee may not be paid upon termination for any remaining sick leave credits that were accrued prior to July 1, 1971. (MCA 2-18-618(6))
- Abuse of sick leave is cause for dismissal and forfeiture of the lump-sum payments for accumulated sick leave. (MCA 2-18-618(8))

Suggested Audit Procedures:

- As part of expenditure testing for personal services, determine that any payments for unused sick leave were only made if the employee terminated employment with the city or town.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

SICK LEAVE - continued:

Suggested Audit Procedures - continued:

- Test selected payments for unused sick leave to determine that the employee was paid an amount equal to ¼ of the pay attributed to the accumulated sick leave earned after 7/1/71, based upon the employee's salary or wage at the time of termination.

10. Compliance Requirement:

- A local government may establish and administer through local rule a sick leave fund into which its employees may contribute a portion of their accumulated sick leave or **Effective July 1, 2007 accumulated vacation leave.** (MCA 2-18-618(10))

Suggested Audit Procedure:

- If the city or town has established a sick leave fund, obtain a copy of the rules adopted for the fund, and determine that the fund is being administered accordingly.

JURY/WITNESS DUTY AND MILITARY LEAVE:

11. Compliance Requirements:

- A city employee who serves on jury duty or serves as a witness has two options: (MCA 2-18-619)
 1. The employee shall collect all fees and allowances payable as a result of the service and forward the fees to the city or town accounting office. Juror and witness fees shall be applied against the amount due the employee from the city or town. The employee is not required to remit to the city or town any expense or mileage allowance paid by the court.
- OR**
- 2. The employee may elect to charge juror and witness time off against annual leave. In this case, he is not required to remit his juror or witness fees to the city or town. The employee is not required to remit to the city or town any expense or mileage allowance paid by the court.
- A city or town employee who is a member of the organized militia of Montana or of the reserve corps or military forces of the United States, and who has been an employee for a period of at least 6 months, must be given leave of absence with pay accruing at a rate of 15 working days in a calendar year for performing military service. This military leave may not be charged against the employee's annual vacation time. In addition, unused military leave must be carried over to the next calendar year, but may not exceed a total of 30 days in any calendar year. (MCA 10-1-1009)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

JURY/WITNESS DUTY AND MILITARY LEAVE - continued:

Suggested Audit Procedure:

- Through inquiry and observation, determine if any city or town employees were absent during the audit period for jury or witness duty, or for military training. If so, verify that the city or town was in compliance with the above statutes.

SALARIES/COMPENSATION OF OFFICIALS & EMPLOYEES:

12. Compliance Requirements:

- The council will determine by ordinance or resolution the salaries and compensation of elected and appointed city or town officers and all city or town employees. (MCA 7-4-4201)
- The salaries that are paid to the city or town officials and employees must be consistent with the budget. (MCA 7-6-4020(4), 7-6-4030, and 7-6-4033)
- The budgeted amounts for personnel services must be supported by a listing of positions, salaries, and benefits for all positions of the municipality. The listings are not required to be part of the budget document. (MCA 7-6-4020(4))

Suggested Audit Procedure:

- As part of expenditure testing for personal services (payroll), determine that salaries for city or town officers and employees were as authorized by the council and specified in the approved budget.

SALARIES OF POLICE DEPARTMENT:

13. Compliance Requirements:

- The minimum salary for the chief of police in first, second, and third class cities must be \$650/month, \$425/month, and \$325/month, respectively, for the first year of service. Thereafter, this minimum salary shall increase by 1% of the minimum base monthly salary for each additional year of service up to and including the 20th year. Subject to such minimum, the salary of the chief of police may be increased from time to time by the mayor, subject to consent and approval of the council. (MCA 7-4-4202)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

SALARIES OF POLICE DEPARTMENT - continued:

13. Compliance Requirements - continued:

- The minimum wage for a member of a police department of first and second class cities for a daily service of 8 hours' work is \$750/month for the first year of service. Thereafter, this minimum salary shall increase by 1% of the minimum base monthly salary for each additional year of service up to and including the 20th year. (MCA 7-32-4116)

Suggested Audit Procedure:

- Determine that the salaries for the chief of police and other members of the police department were at least equal to the minimums specified above.

14. Compliance Requirements:

- A member of a municipal law enforcement agency of a municipality contracting for retirement coverage pursuant to MCA 19-9-207, (Municipal Police Officers' Retirement Act) who is injured in the performance of the member's duties and who requires medical or other remedial treatment for injuries that render the member unable to perform the member's duties must be paid by the municipality, from the initial date of the injury, the difference between the member's net salary, following adjustments for income taxes and pension contributions, and the amount received from workers' compensation until the disability has ceased, as determined by workers' compensation, or for a period not to exceed 1 year, whichever occurs first. (MCA 7-32-4132; AGO #69, Vol. 42)
(**Note:** MCA 7-32-4132 does not provide for accrual of either vacation or sick leave benefits during the period of disability. AGO #114, Vol. 42.)
- Whenever, in the opinion of the municipality, supported by a physician's opinion, the officer is able to perform specified types of light police duty, payment of his partial salary amount under 7-32-4132 shall be discontinued if he refuses to perform such light police duty when it is available and offered to him. Such light duty shall be consistent with the officer's status as a law enforcement officer. With his consent, the officer may be transferred to another department or agency within the municipality. (MCA 7-32-4136)
- When a member of the Municipal Police Officers' Retirement System receives compensation from both the member's employer and as benefits from the workers' compensation program under the provisions of 7-32-4132, the member's compensation reported by the employer is the same as if the member was in active service, and the member, employer, and state retirement contributions required by this chapter must be calculated and paid on that total compensation. (MCA 19-9-706)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

SALARIES OF POLICE DEPARTMENT - continued:

Suggested Audit Procedure:

- Determine that a member of a municipal law enforcement agency contracting for retirement coverage under the Municipal Police Officers' Retirement Act who is injured in the performance of the member's duties and who requires medical or other remedial treatment for injuries that render the member unable to perform the member's duties is paid by the municipality in accordance with the above provisions.

OVERTIME:

15. Compliance Requirements:

- Generally, an employer may not employ any employee for a workweek longer than 40 hours unless the employee receives compensation for employment in excess of 40 hours in a workweek at a rate of not less than 1 ½ times the hourly wage rate at which the employee is employed. (MCA 39-3-405)
(Note: This provision generally agrees to the overtime provisions of the Federal Fair Labor Standards Act (FLSA), which covers virtually all local government employees. (29 CFR §553.3) Elected officials and their appointees are exempt from the FLSA. (29 CFR §553.10) In addition, there are partial exemptions from overtime requirements of the FLSA for fire protection, law enforcement, and hospital employees (see discussions below) (29 CFR §553.32(b)))
- The overtime provisions of MCA 39-3-405 do not apply to the following: (MCA 39-3-406):
 1. An individual employed in a bona fide executive, administrative, or professional capacity, as these terms are defined in Administrative Rules of Montana 24.16.201 through 24.16.205. **(Note:** These Administrative Rules (ARMS) can be accessed through the Secretary of State's Web page at <http://sos.mt.gov/> or the direct link is <http://arm.sos.mt.gov/>)) (MCA 39-3-406(j))
 2. A city/town employee who is working under a work period not exceeding 40 hours in a 7-day period established either through a collective bargaining agreement when a collective bargaining unit represents the employee or by mutual agreement of the employer and employee when a bargaining unit is not recognized. Employment in excess of 40 hours in a 7-day, 40-hour work period must be compensated at a rate of not less than 1 ½ time the hourly wage rate for the employee. (MCA 39-3-406(2)(o))

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

OVERTIME - continued:

15. Compliance Requirements - continued:

3. A firefighter who is working under a work period established in a collective bargaining agreement entered into between a public employer and a firefighters' organization or its exclusive representative. However, the FLSA requires that fire protection employees must be paid overtime for work in excess of 212 hours in a 28-day work period. In the case of such employees who have work period of at least 7 but less than 28 consecutive days, overtime compensation is required when the ratio of the number of hours worked to the number of days in the work period exceeds the ratio of 212 hours to 28 days (i.e., $212 \text{ hours} \div 28 \text{ days} = 7.6$). A city/town employee engaged in fire protection activities, if the city or town employs less than five employees in fire protection activities, is completely exempt from the overtime provisions of the FLSA. (29 CFR §553.201) (**Note:** "employee in fire protection activities" is defined in detail in 29 CFR §553.210 & .211)

4. An officer or other employee of a police department in a first or second class city who is working under a work period established under 7-32-4118. That section provides that the chief of police may establish the work period for officers and other personnel in the department and may establish a work period other than that provided in 39-3-405 for determining when an employee must be paid overtime compensation. The total hours in all work periods in a calendar year may not exceed 2,080. Each officer or other employee of the police force in every city of the first and second class shall, in each calendar year, be given a minimum of 104 days off duty without loss of compensation, not including holidays, sick leave, vacation leave, or other types of compensated time off duty.

Further, MCA 7-32-4119, provides that members of police departments of the first or second class, except those officers holding the rank of captain or above, are entitled to overtime compensation for hours worked in excess of the work period established by the chief of police under 7-32-4118.

The Federal Fair Labor Standards Act (FLSA) requires that law enforcement employees must be paid overtime for work in excess of 171 hours in a 28-day work period. For employees who have a work period of at least 7 but less than 28 consecutive days, overtime compensation is required when the ratio of the number of hours worked to the number of days in the work period exceeds the ratio of 171 hours to 28 days (i.e., $171 \text{ hours} \div 28 \text{ days} = 6.1$). A city/town employee engaged in law enforcement activities, if the city or town employs less than five employees in law enforcement activities, is completely exempt from the overtime provisions of the FLSA. (29 CFR §553.200) (**Note:** "employee in law enforcement activities" is defined in detail in 29 CFR §553.211 & .212)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

OVERTIME - continued:

15. Compliance Requirements - continued:

5. A city/town employee employed, at the employee's option, on an occasional or sporadic basis in a capacity other than the employee's regular occupation. Only the hours that the employee was employed in a capacity other than the employee's regular occupation may be excluded from the calculation of hours to determine overtime compensation. (MCA 39-3-406(2)(x))
- Local government employees who are covered by the FLSA may reach agreement with their employers to receive compensatory time in lieu of cash overtime. Compensatory time in lieu of cash must be at the rate of not less than 1 ½ hours of compensatory time for each hour of overtime worked. (29 CFR §553.20; AGO #58, Vol. 41)

(Note: State and federal law do not require the local government to make the accrual or use of compensatory time available to "exempt" employees (i.e., individuals employed in a bona fide executive, administrative, or professional capacity as discussed above). However, the local government may establish a policy of permitting compensatory time to be earned by "exempt employees" on an "hour-for-hour" basis for time in a pay status in excess of 40 hours in a workweek. Accrued time may be taken as approved time off at a later date.)

1. As a condition for use of compensatory time in lieu of overtime payment in cash, an agreement or understanding must be reached prior to the performance of work. A copy of this agreement or understanding should be kept on file, or if not in writing, a record of its existence should be kept. (29 CFR §553.23(a) & .50)
2. Generally, no more than 240 hours of compensatory time may be accrued. This 240 hour limit is based on 160 hours actual overtime worked. Any additional overtime hours worked over this limit must be paid in cash overtime. (29 CFR §553.21 & .22)
3. However, for those employees engaged in public safety activities (i.e., law enforcement and fire fighting), emergency response activities or seasonal activities, no more than 480 hours of compensatory time may be accrued. The 480 hour limit is based on 320 hours actual overtime worked. Any additional overtime hours worked over this limit must be paid in cash overtime. (29 CFR §553.24)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

OVERTIME - continued:

15. Compliance Requirements - continued:

4. Any employee who has accrued compensatory time and requested use of it must be permitted to use such time off within a reasonable period after making the request, if such use does not unduly disrupt city/town operations. An employee must not be coerced to accept more compensatory time than an employer can realistically expect to be able to grant. (29 CRF §553.25)
5. Upon termination of employment, an employee must be paid for unused compensatory time at a rate not less than the average regular rate received by the employee during the last 3 years of employment, or the final regular rate received by the employee, whichever is higher. (29 CFR §553.21 & .27)
6. The city/town should keep a record of compensatory time earned each workweek, compensatory time used each workweek, and the number of hours of compensatory time compensated in cash and the total amount and date paid, for each employee subject to compensatory time provisions. (29 CFR §553.50)

Suggested Audit Procedures:

- As part of payroll testing, determine if any employees worked in excess of 40 hours in a workweek during the audit period. If so, verify that either cash overtime at the rate of 1 ½ times the employee's regular rate was paid or that compensatory time was accrued for that employee.

(Note to Auditor: For additional information regarding the FLSA see the US Department of Labor's Web site at <http://www.dol.gov/esa/whd/flsa/>.)

- Verify that employees that work within one of the exception activities above and that work over the specified number of hours in a work period either (1) receive overtime pay at the rate of 1 ½ times the employee's regular rate or (2) accrue compensatory time at the rate of 1 ½ hours for each overtime hour worked. (**Exception:** An individual employed in a bona fide executive, administrative, or professional capacity may receive compensatory time on an "hour-for-hour" basis for time in a pay status in excess of 40 hours in a workweek if the local government provides for such a policy. Accrued compensatory time may be taken as approved time off at a later date.)
- Verify that the city/town maintains the necessary records for compensatory time earned. Based on a review of these records, verify that compensatory time is not accrued in excess of the limitations noted above. If compensatory time accrued exceeds these limitations, verify that the excess amount is paid in cash.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

GROUP INSURANCE

16. Compliance Requirements:

- Upon approval by two-thirds vote of officers and employees, the city/town shall enter into group hospitalization, medical, health, including long-term disability, accident or group life insurance contracts or plans for the benefit of the officers and employees and their dependents. (MCA 2-18-702(1)(a))

(Note: For purposes of this compliance requirement, an employee includes a permanent full-time employee; a permanent part-time employee who is regularly scheduled to work 20 hours or more a week; a seasonal full-time employee who is regularly scheduled to work 6 months or more a year or who works for a continuous period of more than 6 months a year although not regularly scheduled to do so; a seasonal part-time employee who is regularly scheduled to work 20 hours or more a week for 6 months or more a year or who works 20 hours or more a week for a continuous period of more than 6 months a year although not regularly scheduled to do so; elected officials; a temporary full-time employee who is regularly scheduled to work more than 6 months a year, who works for a continuous period of more than 6 months a year although not regularly scheduled to do so, or whose temporary status is defined through collective bargaining; and a temporary part-time employee who is regularly scheduled to work 20 hours or more a week for 6 months or more a year, who works 20 hours or more a week for a continuous period of more than 6 months a year although not regularly scheduled to do so, or whose temporary status is defined through collective bargaining. (MCA 2-18-701))

- The city/town governing body may, at its discretion, consider the employees of a private, nonprofit economic development organization to be employees of the city/town solely for the purpose of participation in a group hospitalization, medical, health, including long-term disability, accident, or group life insurance contracts or plans. The governing body may require such an employee or organization to pay the actual cost of coverage or may, at its discretion and subject to any restriction on who may be a member of a group, pay all or part of the cost of coverage of the employee of the organization. (MCA 2-18-702(1)(b))
- The city/town's premium contributions may exceed but may not be less than \$10 a month. (MCA 2-18-703(3))
- An increase in the city/town's property tax levy for premium contributions beyond the amount of contributions in effect at the beginning of the last fiscal year is not subject to the mill levy calculation limitation provided for in MCA 15-10-420, although a public hearing must be held regarding any proposed increases as required by 2-9-212(2)(b). (MCA 2-18-703(3) & 2-9-212)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

GROUP INSURANCE - continued:

16. Compliance Requirements - continued:

- Unused employer contributions for any employee may be transferred to an account established for this purpose by a self-insured government and upon transfer may be used to offset losses occurring to the group of which the employee is eligible or to increase the reserves of the group. (MCA 2-18-703(5))
- Group insurance plans are not prohibited from providing greater or additional contributions for insurance benefits to employees with dependents than to employees with no or with fewer dependents. (MCA 2-18-702(1)(a) & 2-18-703(6))
- AGO #11, Vol. 51, held that a board of county commissioners, in the exercise of its general authority to manage the business of the county and to set compensation for its employees, may offer payment to county employees in lieu of an employee's participation in a group health insurance plan. Although this AGO is specific to counties, it appears that it would also be applicable to cities and towns.
(**Note:** Although MCA 2-18-703(2) prohibits a *state* employee from receiving payment in lieu of participation in a state-sponsored group benefit plan, there is no similar prohibition for local government employees.)
- A city may not contribute to individual employees' insurance plans but must contribute to a city group insurance plan. (AGO #54, Vol. 37)

Suggested Audit Procedures:

- If a city/town has entered into a group insurance plan for its employees, determine that only eligible employees, as defined above, are allowed to participate in the plan.
- Verify that the city/town's premium contribution to the plan is at least \$10 a month per employee.
- If there has been an increase in the city/town's property tax levy for premium contributions beyond the amount of contributions in effect at the beginning of the last fiscal year, which is not subject to the mill levy calculation limitation provided for in 15-10-420, determine that a public hearing was held regarding any proposed increases.

17. Compliance Requirement:

- If cities provide insurance for other city employees under Title 2, Chapter 18, Part 7, MCA, (see Compliance Requirement #15, above), they must also provide the same insurance to their police officers. Notwithstanding the provisions of Title 2, Chapter

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

GROUP INSURANCE - continued:

17. Compliance Requirement - continued:

18, Part 7, MCA, the city shall pay no less than the premium rate in effect as of 7/1/80, for insurance coverage for police officers and their dependents. The city shall also provide for collective bargaining or other agreement processes to negotiate additional premium payments beyond this amount. (MCA 7-32-4117)

Suggested Audit Procedure:

- Determine that the city has provided insurance benefits to its police officers, as discussed above.

VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATION (VEBA):

18. Compliance Requirements:

(Note: The VEBA, which is centrally administered by the Montana Department of Administration, provides members with individual health care expense trust accounts to pay qualified health care expenses of members, their dependents, and their beneficiaries. Under the plan, employer contributions, investment earnings, and payments for qualified health care expenses are tax-exempt. A local government, however, is not prohibited from establishing a similar program as an alternative or in addition to participation in the State VEBA plan discussed here. For more information on VEBA see:

[http://www.montanaveba.org/.](http://www.montanaveba.org/))

- As either initiated by the local government (the contracting employer), or at the request of at least 25% of its employees, the local government may hold an election to determine whether all the employees, or a specified group of employees, will form an association for the purpose of participating in the plan. If a majority of employees vote to form an association, all current and subsequently-hired employees must become plan members. The local government shall enter into a contract with the Department of Administration, and shall operate the association in a manner prescribed by that Department. (MCA 2-18-1310)
- In a manner prescribed by the Department, a local government shall provide for a plan member to annually designate how many hours, if any, of the member's sick leave will be automatically converted to an employer contribution to the member's account each pay period. A member may annually convert only sick leave hours in excess of 240 hours, and no more than the maximum prescribed by the local government. (MCA 2-18-1311(1) & (2)(a))

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATION (VEBA) - continued:

18. Compliance Requirements:

- When the member's employment is terminated, the member's entire unused sick leave balance must be automatically converted to an employer contribution to the member's account, and may not be paid as a lump sum under MCA 2-18-618(6) (See Compliance Requirement No. 8, above). (MCA 2-18-1311(2)(b))
- The amount of the employer contribution for hours converted must be equal to $\frac{1}{4}$ of the accumulated sick leave, and must be computed on the basis of the employee's salary or wage at the time of the conversion. A member may not later receive as sick leave credit or as a lump-sum payment amounts contributed to the member's account pursuant to 2-18-1311. (MCA 2-18-1311 (3))

Suggested Audit Procedures:

- Through inquiry, determine whether the city/town's employees, or specified group of employees, voted to become members of the "Voluntary Employees' Beneficiary Association (VEBA)" administered by the Department of Administration. If so, obtain and review a copy of the contract with the Department.
- Verify that all employees, or all members of the specified group of employees, are members of the plan; and that they have, in a manner prescribed by the Department, designated annually how many hours, if any, of each member's sick leave will be automatically converted to an employer contribution to the member's account each pay period.
- Determine that each member annually converts only sick leave hours in excess of 240 hours, and no more than the maximum prescribed by the local government.
- Determine that when the member's employment is terminated, the member's entire unused sick leave balance is automatically converted to an employer contribution to the member's account, and that it is not paid as a lump sum.
- Verify that contributions are calculated correctly, and that members do not later receive sick leave credits or lump-sum payments for amounts contributed.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS:

State and Federal Tax Withholdings:

19. Compliance Requirements:

(Note: Compliance Requirements for State tax withholding guidelines are from “Employer’s Tax Guide” produced by the Montana Department of Revenue. See “Publication 15, Circular E, Employer’s Tax Guide” produced by the Internal Revenue Service for Federal tax withholding guidelines.) {The web link for the “Employer’s Tax Guide” is http://mt.gov/revenue/formsandresources/forms/Employer's_Tax_Guide.pdf)

- The amount of state and federal taxes withheld from an employee’s wages is based on the marital status and withholding allowances indicated on the employee’s federal Form W-4. An employee can have a separate W-4 for state purposes, and may elect to have a different number of allowances for federal and state purposes. If line 5 of the Form W-4 is left blank, the employee is deemed to be claiming zero withholding allowances. Withholdings may not be based on a fixed dollar amount or percentage, although the employee may specify an additional dollar amount to be withheld.
- Although an employee may claim exemption from federal income tax withholding, there is no such provision for exemption from Montana state income tax withholding. If a federal exemption is claimed, wages for that employee are still subject to Social Security and Medicare taxes.
- The local government is required to remit its withholding payments to the State on a schedule (quarterly, monthly, or accelerated) determined by the State. The most common remittance schedules are quarterly or monthly.
- Salaries and wages of elected city/town officials are subject to State income tax withholding.
- Payments to employees that are not subject to State income tax withholding include:
 1. Employee business expense reimbursements, as long as each reimbursement is entered separately in the city’s or town’s records and there is documentation that the expenses were incurred while conducting business. Reimbursements must be based upon actual, receipted expenses, or on meal, lodging and mileage amounts allowed to State employees.
 2. Employer payments or contributions for employee benefit group plans, such as retirement, sickness or accident disability, medical, hospitalization or death.
 3. Employee contributions to qualifying annuity contracts, such as annuity plans or deferred compensation plans.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued:

State and Federal Tax Withholdings - continued:

4. Employee contributions to flexible spending accounts for medical and/or dependent care and health, dental and/or vision insurance premiums that exceed the employer's contribution.

(**Note:** Technically, these employee "contributions" are actually payments deducted from an employee's gross pay for cafeteria (aka Section 125) plans. Typically, the payroll records will show "gross wages", "Medicare wages", "Social Security wages", etc. to show the amount of applicable wages to which the tax rate is applied.)

Suggested Audit Procedures:

- As a part of payroll testing, verify that there is a current W-4 form on file for each selected employee.
- For selected individuals, verify that payments either are, or are not, subject to withholding as described above.
- If considered necessary, verify that withholdings for selected individuals agree to withholdings in the State Withholding Tax Tables that coincide with the marital status and allowances designated on the individual's Form W-4.
- If deemed necessary, test federal withholdings for compliance with Federal laws and regulations as specified in "Publication 15, Circular E, Employer's Tax Guide".

State Unemployment Insurance:

20. Compliance Requirements:

(**Note:** Compliance Requirements are from "Montana Unemployment insurance Employer Handbook" produced by the Montana Department of Labor and Industry. A copy of the handbook may be obtained on the web at <http://uid.dli.mt.gov/TAX/handbook/handbookcover.asp>)

- All local governments must be covered by State unemployment insurance. (**Note: Local governments are exempt from Federal unemployment insurance.**) Unemployment insurance contributions are paid by the employer, and no part of the contributions may be withheld from an employee's wages. Local governments may choose coverage either as a "reimbursable employer", or may choose to make tax payments based on the "governmental experience rate" system where their tax rate is applied to total wages. Whatever option is elected, the local government must also pay a 0.05% (.0005) Administrative Fund Tax on total wages paid each quarter. (MCA 39-51-1103, & 39-51-404)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued: **State Unemployment Insurance - continued:**

20. Compliance Requirements - continued:

1. Reimbursable Employer – the local government is required to submit quarterly wage reports on total wages paid each quarter. The Montana Department of Labor and Industry then notifies the local government monthly of the benefits charged to the local government's account. These charges may be paid monthly or the entire quarterly charges may be paid within thirty days following the end of the quarter.
 2. Experience Rating System – The local government is required to pay taxes, at a rate calculated by the State, on the wages of each employee up to and including the taxable wage base for that year. The taxable wage base is listed in the upper left hand corner of the quarterly report form. The taxable wage base for calendar year 2001 was, \$18,200; 2002 was \$18,900; 2003 was \$19,700; 2004 was \$20,300; 2005 was \$21,000; 2006 was \$21,600; 2007 was \$22,700, and 2008 is \$23,800. Once the individual employee's wages reach the taxable wage base for the year, the employee's quarterly wages are still reported, but taxes are no longer paid on them.
- The following are considered to be wages for purposes of unemployment insurance:
 1. Holiday pay, vacation pay, sick leave payments, overtime cash payments, severance or continuation pay, and back pay.
 2. Payments deducted from an employee's gross pay for cafeteria plans, deferred compensation plans, and sickness, disability, medical or hospital insurance plans.

Also, state and federal income tax withholdings and social security taxes do not reduce reportable wages.
(MCA 39-51-201)

- The following are not considered to be wages for purposes of unemployment insurance:
 1. Contributions made by the employer for retirement, sickness or accident disability, medical, hospitalization or death employee benefit plans, if employees may not elect to receive cash instead of coverage. The plan must be one established for all employees or for a specific class of employees. Employer contributions for all other employee benefit plans are reportable as wages.
 2. Payments made to reimburse an employee for business expenses, if certain rules are followed. Each reimbursement must be entered separately in the employer's records, and there must be documentation that the expense was incurred while conducting business. The reimbursement must be based upon actual, receipted expenses, or upon the per-diem and mileage amounts allowed to State employees.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued: **State Unemployment Insurance - continued:**

20. Compliance Requirements - continued:

3. Salaries and wages of elected public officials.
(MCA 39-51-201(24)(b))

Suggested Audit Procedure:

- Review selected quarterly unemployment payroll reports to verify that all wages, as defined above, are included. Also, verify that employer contributions for employee benefit plans described above, employee business expense reimbursements, and salaries and wages of elected public officials are not included in the payroll reports.

Workers' Compensation:

21. Compliance Requirements:

- The Workers' Compensation Act of Montana, with limited exceptions, requires all employers to cover their full-time, part-time, seasonal, or occasional employees with workers' compensation insurance. All workers' compensation insurance premiums are to be paid by the employer. Employers may not deduct any part of the premiums from employees' pay. (MCA 39-71-406)
- An employer has three options for coverage: Plan 1 - self insured, Plan 2 – private insurance companies, and Plan 3 – Montana State Fund. The premium that an employer pays is based on a percentage of the employees' payroll, which is in turn based on a class code rate and an experience modification factor. The payment schedule is spelled out in the individual employer's insurance policy. (Title 39, Chapter 71, Parts 21, 22 & 23, MCA)
- All elected and appointed paid public officers are considered to be employees for purposes of workers' compensation coverage. (MCA 39-71-118(1)(a)) An enrolled member of a volunteer fire department of a 2nd-class city, or a person who provides ambulance services for a local government is also considered to be an employee for this purpose. (MCA 39-71-118(1)(g);)
- Generally, a volunteer is not considered to be an employee for purposes of workers' compensation coverage. (MCA 39-71-118(2)(c))
- Each law enforcement agency that utilizes reserve or special services officers shall provide full workers' compensation coverage while the officers are providing actual service for a law enforcement agency. (MCA 7-32-203)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued: **Workers' Compensation - continued:**

21. Compliance Requirements - continued:

(**Note:** For example, members of a recognized search and rescue unit are auxiliary officers and must be provided full workers' compensation coverage when engaged in a search, training, or testing operation called and supervised by the Sheriff. AGO #97, Vol. 42)

Suggested Audit Procedures:

- As part of payroll testing, verify that no part of the employer's workers' compensation insurance premium is paid through employee payroll deductions.
- Verify that all employees, including elected and appointed city or town officials, are covered by workers' compensation insurance. Verify also that any volunteer firefighters or law enforcement reserve officers are covered by workers' compensation insurance if they meet the criteria discussed above.

Social Security and Medicare:

22. Compliance Requirements:

(See below for historical background and additional detail.)

- Local government employees are covered by Social Security and Medicare in one of two ways.
 - a. Through a federal-state agreement called a Section 218 agreement (authorized under Section 218 of the Social Security Act). Those agreements should specify the Social Security and Medicare coverage for local government employees. Employees covered for social security under a Section 218 agreement are automatically covered for Medicare. There may be exclusions for certain groups of employees.
 - b. Under the Mandatory provisions of federal law, as noted below:
 - I. Employees hired (or rehired) after March 31, 1986, must have mandatory Medicare coverage unless the law specifically excludes them.
 - II. A local government employee hired on or before March 31, 1986, and whose employment relationship with the local government has not been terminated, is exempt from Medicare and Social Security taxes - this is known as the "continuing employment exception". Effective July 1, 1991, this exception is available only to employees who participate in a public retirement system. (Entities may voluntarily extend Medicare coverage to these employees under a Section 218 Agreement.)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued:

Social Security and Medicare - continued:

22. Compliance Requirements - continued:

III. Current law requires local government employees not covered by a Section 218 agreement or a public retirement system to be covered by Social Security and Medicare, unless the law specifically excludes them.

- The employer and employee tax rates for Social Security are both 6.2% (12.4% total). The employer and employee tax rates for Medicare are both 1.45% (2.9% total). The wage base limit (i.e., the maximum wage that is subject to tax) for Social Security changes periodically. For 2003, the limit was \$87,000, and for 2004, the limit is \$87,900; for 2005 the limit was \$90,000; and for 2006 the limit was \$94,200; for 2007 the limit was \$97,500; and for 2008 the limit was \$102,000. There is no wage base limit for Medicare. Also, payments deducted from an employee's gross pay for cafeteria plans (aka, Section 125 plans) are not subject to social security and Medicare withholdings.

Suggested Audit Procedures:

- Determine whether the local government entity is covered by a Section 218 agreement.
- If it is, obtain and review a copy of the Section 218 agreement.
- As part of payroll testing, determine that employee coverage for Social Security and Medicare is in accordance with the entity's Section 218 agreement.
- Determine whether the local government entity is covered by a Section 218 agreement. If so, obtain and review a copy of the Section 218 agreement. As part of payroll testing, determine that employee coverage for Social Security and Medicare is in accordance with the entity's Section 218 agreement.
- If the entity is not covered by a Section 218 agreement, determine whether the entity is a participant in a public retirement system (PERS). If not, verify that the entity is providing mandatory Social Security and Medicare coverage. (If the entity is in a PERS, they may also optionally provide Social Security and Medicare coverage.)
 - If the entity is a participant in a PERS, verify that the entity is providing Medicare coverage to its employees that were hired after 3/31/86.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued:

Social Security and Medicare - continued:

Suggested Audit Procedures - continued:

- If the entity is a participant in a PERS, determine whether employees hired prior to 4/1/86 are covered by a Section 218 Agreement that provides Medicare-only coverage. If so, determine that the entity is providing Medicare-only coverage for those employees.
- If employees hired prior to 4/1/86 are not covered by a Section 218 Agreement that provides Medicare-only coverage, determine whether the Medicare Continuing Employment Exception applies. If this Exception doesn't apply, verify that the entity is providing Medicare-only coverage for those employees. (If the Exception does apply – there is no requirement that the entity provide Social Security or Medicare coverage for employees hired prior to 4/1/86.)
- For employees covered by social security and/or Medicare under either a Section 218 agreement or mandatory federal laws and regulations, test to determine that employee withholdings and employer contributions are in accordance with applicable federal laws and regulations. For selected individuals whose wages exceed the social security wage base limit, verify that no social security tax was withheld for the portion of the wages that exceeded the wage base limit. Also, verify that Medicare tax was withheld on the portion of the wages that exceeded the social security wage base limit.
- If a local government has recently consolidated, verify that a new Section 218 agreement has been obtained, if necessary. The State Social Security Administrator should be contacted for this information. (Section 218 agreements of the two “pre-consolidation” entities may no longer be applicable to the consolidated government.)

SOCIAL SECURITY AND MEDICARE TAXES –HISTORICAL BACKGROUND & ADDITIONAL INFORMATION

- When the Social Security Act was enacted in 1935, public employees were not eligible for social security coverage. In 1950 Congress created Section 218 of the Social Security Act, which allows states to enter into voluntary agreements for social security coverage with the Social Security Administration. After a state has an agreement in place, it can then enter into voluntary agreements with political subdivisions within their state.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued:

Social Security and Medicare - continued:

SOCIAL SECURITY AND MEDICARE TAXES –HISTORICAL BACKGROUND & ADDITIONAL INFORMATION – continued:

- A Section 218 Agreement is a written agreement voluntarily entered into between a state and the Social Security Administration, to provide social security and Medicare or Medicare-only coverage to employees of state and/or local governments. Local government employees covered under the Agreement have the same coverage and benefit rights as employees in the private sector. All states have a Section 218 Agreement, but the extent of coverage varies.
- Section 218 Agreements are permanent and cannot be terminated.
- Effective February 2008, the Local Government Services Bureau of the Montana Department of Administration is the official State Social Security Administrator for administering the State's Section 218 Agreements. (See Title 19, Chapter 1, Part 1, MCA.)
- In Montana, for a local government to have the Section 218 Agreement approved, a referendum must be held and the majority (over 50%) of all eligible employees within the local government (or group) requesting the Agreement, must vote to approve the Agreement. If an eligible employee chooses not to vote for the Agreement, it is considered a 'no' vote. Once the local government has consensus from its eligible employees, then the Agreement is sent to the Social Security Administrator for review and signature. Once reviewed and signed, the Agreement is forwarded to the Governor for approval.
- If a local government consolidates (i.e., a city with a county or an elementary school with a high school) the entity may need to obtain a new Section 218 Agreement.

(Note: More detailed information on Social Security and Medicare coverage for local government employees can be obtained from the following:

Social Security Administration
10 West 15th Street, Suite 1600
Helena, MT 59626

Internal Revenue Service
10 West 15th Street, Suite 2300
Helena, MT 59626

State Social Security Administrator
Department of Administration
Local Government Services Bureau
301 South Park Avenue – Room 340
PO Box 200547
Helena, MT 59620
(406) 841-2909

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued:

Social Security and Medicare - continued:

SOCIAL SECURITY AND MEDICARE TAXES –HISTORICAL BACKGROUND & ADDITIONAL INFORMATION – continued:

A flowchart for determining Social Security and Medicare coverage for state and local government employees can be found at - <http://www.ssa.gov/slge/>

This flowchart also contains a link to the *State and Local Coverage Handbook* that is a recommended source of information.

Section 218 agreements for a particular local government should be on file with the local government. In addition, a copy should be available from the State Social Security Administrator. As noted above, the **Local Government Services Bureau of the Department of Administration** acts as Montana's State Social Security Administrator.

FEDERAL INFORMATION RETURNS:

23. Compliance Requirement:

- The entity must report on a Federal Information Return, Form 1099-MISC, all payments of \$600 or more which the entity makes during a calendar year to anyone, other than a corporation or tax-exempt organization, who is not an employee. (U.S. Internal Revenue Service Codes)

(Note: The following are some examples of payments to be reported on Form 1099-MISC. For a complete list, contact the IRS:

- Professional service fees, such as fees to attorneys (including corporations), accountants, architects, contractors, subcontractors, etc.
- Payments by attorneys to witnesses or experts in legal adjudication.)

Suggested Audit Procedure:

- As part of expenditure testing, determine that the entity filed a Form 1099-MISC for each payee who was not a corporation or tax-exempt organization to which the entity paid \$600 or more for contracted services during the calendar year.

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

IMMIGRATION AND NATURALIZATION SERVICE (INS) FORM I-9:

24. Compliance Requirement:

- An employer is responsible for ensuring that a completed Form I-9 is retained on file for all employees hired after November 6, 1986. Section 1 of the Form is to be completed and signed by the employee at the time of hire. The employer is required to complete Section 2 by examining evidence of identity and employment eligibility within three business days of the date employment begins.

Suggested Audit Procedure:

- Verify that the city/town has a completed Form I-9 on file for any employee hired after November 6, 1986.

RECORDKEEPING:

25. Compliance Requirement:

- OMB Circular A-87 and Section 39-3-401, MCA, require employers to keep time and effort records. In reviewing the School Accounting Manual, Section 5-1870, it also suggests that the following other records be kept, which seem to be relevant to a city or town government:
 - ◆ Monthly payroll recap
 - ◆ Monthly Tickler file
 - ◆ Payroll Manual/Notebook
 - ◆ Decedent's Designation to Receive Warrants

Suggested Audit Procedure:

- Determine if time and effort records were kept as required by federal and state laws and regulations. Also, check to see if other records were kept as suggested above.

EMPLOYEE PAYSTUB:

26. Compliance Requirement:

- All employers in this state when making payment to employees for salaries or wages shall, upon making such payment, give to the employee an itemized statement setting forth moneys deducted because of state and federal income taxes, social security, or any other deductions together with the amount of each deduction. Where no deduction is made, the employer shall give to the employee a statement that the payment does not include any such deductions. (MCA 39-3-101)

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

EMPLOYEE PAYSTUB - continued:

Suggested Audit Procedure:

- Through inquiry and observation determine if employee pay stubs include the information as required by MCA 39-3-301.

NEW HIRE REPORTING:

27. Compliance Requirements:

- Federal law states that an “employer” for New Hire reporting purposes is the same as for Federal income tax purposes (as defined by Section 3401(d) of the Internal Revenue Code of 1986) and includes any governmental entity or labor organization. At a minimum, in any case where an employer is required to have an employee complete a W-4 form, the employer must meet the New Hire reporting requirements.

(Note: For more information regarding this Federal law see:

<http://www.acf.hhs.gov/programs/cse/newhire/employer/private/newhire.htm>

and for a listing of state new hire reporting contacts see:

[http://www.acf.hhs.gov/programs/cse/newhire/employer/contacts/nh_matrix.htm - MT .\)](http://www.acf.hhs.gov/programs/cse/newhire/employer/contacts/nh_matrix.htm - MT .)

- The penalty set by Federal law for failing to comply with the New Hire reporting requirements is set at \$25 per newly hired employee. If, however, there is a conspiracy between the employer and the employee not to report, the penalty may not exceed \$500.
- This law requires every Montana employer to report a minimal amount of information on each new employee hired or rehired on or after October 1, 1997. This information includes: **Employer:** *Name; Address; Federal Employer; and Identification Number;* **Employee:** *Name; Address; Social Security #; and Date of Hire.*
- Reports must be submitted within 20 days of the date the employee is hired or rehired. For more information see the Department of Revenue’s Web site at <http://mt.gov/revenue/formsandresources/forms/newhirereporting.pdf>.

(MCA 40-5-922)

(For a copy of the Montana Employer’s Guide to New Hire Reporting see

<http://www.dphhs.mt.gov/csed/relatedtopics/newhirebooklet.pdf>

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COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

NEW HIRE REPORTING - continued:

Suggested Audit Procedure:

- Determine if the city or town hired any employees during the audit period. If so, verify that the city or town remitted the appropriate information to the Department of Revenue within 20 days of the new employee's hiring date.

LOCAL GOVERNMENT CONTRACT AUTHORITY

28. Compliance Requirement:

- It is within a city or town's contract authority to enter into any contract necessary for the exercise of its power, including but not limited to a contract for reimbursement that may require that the city or town be reimbursed for the cost of basic course training if an employee leaves employment before completing a reasonable period of service. (MCA 7-1-4105(4)) (**Note:** MCA 7-32-4139 gave statutory authority to cities and towns for a hiring contract provision requiring that the city or town be reimbursed for the cost of a police officer's basic course training if the officer leaves employment as a police officer before completing at least 36 months of service. The 2005 Legislature (HB 743) repealed 7-32-4139 on the finding that the ability to include these provisions in any employment contract is within the contract authority granted to local governments and statutory authorization is unnecessary.)

Suggested Audit Procedure:

- **None** – This compliance requirement is included for informational purposes only.